# Redeemable preference shares under the Corporations Act

*Weinstock v Beck* [2011] NSWCA 228 (17 August 2011)

In *Weinstock v Beck* the NSW Court of Appeal addressed a narrow but significant point of corporations law on which there was no direct authority. Under the *Companies Act 1961* (NSW) and the *Corporations Act 2001* (Cth) a company may only issue shares that are liable to be redeemed if the shares are 'preference shares': 1961 Act, ss 61(1) and 66(1); 2001 Act, ss 254A(1) and (3) and 254J. In *Weinstock* the court held, by majority, that shares with *potential* preferential rights that lack effective content because there are no lower-ranked shares on issue will nonetheless be 'preference shares' and, accordingly, may be made redeemable. Although the decision related to shares issued under the 1961 Act the court's reasoning is equally applicable to shares issued under the 2001 Act.

## Background

The issue arose in the context of a dispute about the validity of a purported redemption of shares by LW Furniture Consolidated (Aust) Pty Ltd (company). The Company was incorporated in 1971. Its Memorandum and Articles of Association provided for its authorised share capital to be designated into four classes of preference shares classified 'A' to 'D' and ten classes of ordinary shares. The only shares allotted were 'A', 'C' and 'D' class preference shares.

The 'C' and 'D' class shares were styled 'Redeemable Preference Shares' and the rights of the two classes provided for by the Articles of Association were identical. The shares carried rights of return of capital after the 'A' and 'B' class shares and 'in priority to all other shares in the capital of the company' as well as dividend rights. The 'C' and 'D' class shares were liable to be redeemed at par by the company upon the death of the holder.

In 2004 the company purported to redeem, at par, 8 'C' class shares issued to Ms Hedy Weinstock, then recently deceased. One of Ms Weinstock's executors commenced proceedings challenging the validity of the purported redemption. The par value of Ms Weinstock's shares was $8 whereas the executor claimed that the true value of her shares on winding up would be over $7 million.

The executor contended that Ms Weinstock's shares were not 'preference shares' issued in accordance with s 61(1) of the 1961 Act (and therefore liable to be redeemed) because, at the time they were issued, there were no 'other shares' on issue by the company over which they took preference. Properly characterised, the shares were ordinary shares that could only be cancelled under a reduction of capital or a share buy-back. Hamilton AJ accepted that contention and held that the redemption was invalid.

## Reasoning

A majority of the Court of Appeal (Giles JA and Handley AJA, Young JA dissenting) held that the shares were properly characterised as 'preference shares' issued under s 61(1) of the 1961 Act and the redemption was valid. Handley AJA, with whom Giles JA agreed, reasoned as follows.

First, the logical consequence of the executor's argument was that Ms Weinstock's shares were never validly issued, not that they should be treated as being validly issued but non-redeemable. The executor's submission required that the directors of the company be taken to have issued 'C' class shares with different rights to those set out in the Articles of Association, yet the directors had no power to amend the Articles of Association by themselves to permit the issue of such shares. The process contended for bore some analogy to rectification of the Articles of Association for mistake, which would not have been available had it been sought (at [129]–[132]). Whether shares were preferential was properly determined by reference to the Articles of Association and not the state of the Company's share register (at [146]).

Secondly, there was a distinction between the rights attached to shares and the practical content or enjoyment of those rights (at [134]). 'C' and 'D' class shareholders had preferential rights under the Articles of Association but until ordinary shares were issued those rights were 'potential', in the sense that they had no effective content. Handley AJA pointed out that potential preferential rights were not unusual, for instance, a preferential right to a dividend is potential in the sense that it is dependent on the company earning divisible profits (at [149]).

Thirdly, the decision of Barrett J in *Re Capel Finance* (2005) 52 ACSR 601, on which the executor relied, was

distinguishable. In that case, Barrett J stated that it was not possible for preference shares to exist 'except as a result of a process of differentiation from shares which are not 'preference shares''. However his Honour was addressing a situation where no provision was made for even *potential* preferential rights. He did not consider the situation where the articles conferred preferential rights on the holders of the relevant shares but those rights lacked effective content (at [138], [144]).

Young JA, in dissent, considered that preference shares were shares which had preferred rights over another class of share on issue, such that if there is no other class of share on issue, there cannot be any preference shares (at [75]). His Honour accepted the executor's argument that unless the expression 'preference shares' were interpreted in this way, there could be a situation in which the only issued shares of a company were redeemable, circumventing the basic rule against the reduction of capital (at [23]).

**Discussion**

The case was argued on the basis that the 1961 Act was the relevant statute because it was in force at the time the shares were issued (see [111]). However, the majority's reasoning applies with equal force to redeemable preference shares purportedly issued and redeemed under the 2001 Act (see ss 9, 254(1) and (3), 254J and 254K). Young JA observed that the provisions of the two statutes relating to redeemable preference shares were the same in substance (at [26]–[29]). For the time being, the decision should probably be regarded as governing the position under the 2001 Act as well.

An application for special leave to appeal has been filed by the executor.

**James Hutton**

# Verbatim

It is difficult to say that the present system works well: counsel sometimes show little foresight of what issues will really influence decision, and legislators send many disputes to new tribunals, always with the expressed hope of simpler process. Notice of what is to be debated is basal to fairness at the hearing. As the court passed to a modern system and contemporary language a great opportunity was marred by lapse in the perceived value of definition of issues and the attention the Profession has given to it. The production of clear issues to which the hearing is addressed has come to seem less imperative. Sometimes a case is presented as a formless narration, in the manner of James Joyce. My experience since 1972, including experience on the Bench, has led me to regret the inattention of the Profession to ascertainment and definition of issues: many do not seem to understand the concept, let alone use or value it.

**The concluding paragraph of the Hon. J.P. Bryson QC's masterly lecture 'Common Law Pleadings in New South Wales and how they got here' which was delivered on 30 August 2011 under the sponsorship of the New South Wales Bar Association, the Francis Forbes Society and the Selden Society. The full text of the lecture is available on the Supreme Court website under the link 'speeches by former judges'.**